



201 West Main Street, Suite 14
Charlottesville, VA 22903-5065
434-977-4090
Fax 434-977-1483
SouthernEnvironment.org

February 5, 2009

VIA ELECTRONIC FILING

Mr. Charles Terreni
Chief Clerk/Administrator
South Carolina Public Service Commission
101 Executive Drive
Columbia, SC 29210

Re: Surrebuttal Testimony of Brian Henderson and Rick Hornby on behalf of
Southern environmental Law Center et al in South Carolina Public Service
Commission Docket No. 2008-251-E.

Dear Mr. Terreni:

Please find enclosed the surrebuttal testimony of Brian Henderson and Rick
Hornby on behalf of Southern Environmental Law Center, Natural Resources Defense
Council, the Southern Alliance for Clean Energy and the South Carolina Coastal
Conservation League in the above-mentioned docket.

Yours truly,

Christopher K. DeScherer
Senior Attorney

Enclosures

1
2
3 **I. INTRODUCTION / SUMMARY**

4 **Q. PLEASE STATE YOUR NAME, BUSINESS, AND PRESENT ADDRESS.**

5 A. My name is Brian Henderson. I am an independent energy consultant with a business
6 address of 527 Inverrary Street, Murrells Inlet, SC 29576.

7 **Q. ARE YOU THE SAME BRIAN HENDERSON WHO SUBMITTED PRE-FILED
8 DIRECT TESTIMONY IN THIS PROCEEDING?**

9 A. Yes.

10 **Q. WHAT IS THE PURPOSE OF YOUR SUR-REBUTTAL TESTIMONY?**

11 A. My surrebuttal testimony responds to certain points regarding my direct testimony that
12 Mr. B. Mitchell Williams makes in his rebuttal testimony on behalf of Progress Energy
13 Carolinas ("PEC" or "the Company") in this docket. The fact that I do not respond
14 explicitly to other points in that rebuttal testimony does not mean I agree with those other
15 points.

16 **Q. DID MR. WILLIAMS CHALLENGE THE CONCLUSIONS PRESENTED IN
17 YOUR DIRECT TESTIMONY REGARDING THE NEED TO ESTABLISH
18 ENERGY-USE REDUCTION TARGETS COMPARABLE TO THOSE BEING
19 ACHIEVED BY OTHER UTILITIES AROUND THE COUNTRY?**

20 A. On pages 3 and 4, and again on page 10, Mr. Williams argues that other state
21 achievements should not be used as benchmarks in South Carolina because, in his
22 opinion, making comparisons to states like New York and California is of little value.
23 However, Mr. Williams overlooks the references in my direct testimony to other states
such as Arizona, which faced similar conditions to those of South Carolina and have

achieve an incremental annual reduction of electricity use through energy efficiency of at least 0.75% of retail sales by 2013, and a cumulative reduction of at least 1.85% over a 5-year period.

Percentage of MWh Sales

	0.10	0.20	0.30	0.50	
			0.70	0.80	
					*
rogram					

DID MR. WILLIAMS INDICATE FACTORS THAT CAN IMPACT ANY STATE-TO-STATE COMPARISONS?

Yes. Mr. Williams indicated that the utility's mix of customers must be considered, in that PEC is proposing to allow an opt-out opportunity for its industrial and large commercial customers in South Carolina. Mr. Williams states that large commercial and industrial customers are constantly evaluating and making investments in energy efficiency on their own, without the need for DSM/EE program.

Based on my years of experience in working with large commercial and industrial customers and administering DSM/EE programs, this is not entirely accurate. Significant untapped, cost-effective energy-efficiency opportunity remains in the industrial sector. Often, plant managers fail to recognize the potential for energy efficiency at their facilities. Even very savvy plant managers, faced with high retail electric rates, focus on plant operations ahead of energy efficiency.

Encouraging this sector to actively participate in a DSM/EE program, specifically designed to address their needs, should achieve substantial savings. An energy efficiency

1 program with an in-depth technical assistance component that provides industrial
2 ratepayers with the services of experienced energy management engineers. These, in
3 turn, can overcome barriers to energy efficiency in industry by identifying opportunities,
4 assessing technical feasibility, commissioning equipment to correct energy-related
5 problems and ensure system optimization, and providing necessary technical or financial
6 justification to secure top management support for energy efficiency investments.
7 Furthermore, utility-run industrial energy efficiency programs often offer financing to the
8 project, not otherwise available to the plant manager, that makes the project more
9 attractive.

10 **Q. DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?**

11 **A. Yes.**

I. INTRODUCTION / SUMMARY

Q. PLEASE STATE YOUR NAME, EMPLOYER, AND PRESENT POSITION.

A. My name is J. Richard Hornby. I am a Senior Consultant at Synapse Energy Economics, Inc., 22 Pearl Street, Cambridge, MA 02139.

Q. ARE YOU THE SAME J. RICHARD HORNBY WHO SUBMITTED PRE-FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. My surrebuttal testimony responds to certain points regarding my direct testimony that Ms. Laura Bateman makes in her rebuttal testimony on behalf of Progress Energy Carolinas ("PEC" or "the Company"). The fact that I do not respond explicitly to other points in that rebuttal testimony does not mean I agree with those other points.

Q. DID MS. BATEMAN CHALLENGE THE FIRST TWO CONCLUSIONS PRESENTED IN YOUR DIRECT TESTIMONY REGARDING RECOVERY OF EFFICIENCY PROGRAM COSTS IN GENERAL?

A. No. The first two conclusions in my Direct Testimony are that:

- It is reasonable for the Company to have a set of cost recovery procedures that enable it to recover the prudently incurred costs of its EE and DSM programs, plus a reasonable financial incentive and a reasonable mechanism for minimizing adverse impacts on its earnings from those programs; and
- The Company bears the burden of proving that the specific set of cost recovery procedures it is proposing will result in rates that are just and reasonable.

1 Ms. Bateman did not express any disagreement with those two conclusions.

2 **Q. DID MS. BATEMAN CHALLENGE THE CONCLUSIONS IN YOUR DIRECT**
3 **TESTIMONY REGARDING THE COMPANY'S SPECIFIC PROPOSALS FOR**
4 **COST RECOVERY?**

5 A. Yes. Ms. Bateman challenged the conclusions in my Direct Testimony regarding the
6 Company's specific proposals for cost recovery. Those conclusions are that the
7 Company has failed to demonstrate that:

- 8 • The specific set of cost recovery procedures it is proposing will result in rates that
9 are just and reasonable;
- 10 • The Program Performance Incentive ("PPI") levels that PEC is proposing,
11 alongside the return on equity it will earn on the unamortized program cost
12 balances, is reasonable; and
- 13 • Recovery of net lost revenues for three years is the best approach for minimizing
14 adverse impacts on its earnings from those programs.

15 **Q. YOUR DIRECT TESTIMONY NOTES THAT THE COMPANY HAS NOT**
16 **DEMONSTRATED THE ACTUAL OPERATION OF ITS PROPOSED COST**
17 **RECOVERY PROCEDURES OVER THE FULL COST RECOVERY PERIOD.**
18 **PLEASE SUMMARIZE YOUR POSITION AND DISCUSS MS. BATEMAN'S**
19 **RESPONSE.**

20 A. As noted in my Direct Testimony, the Company is proposing a specific approach out of
21 the range of possible approaches available for recovering its program costs, earning a
22 performance incentive and minimizing the adverse impact on earnings from its programs.

1 From a ratemaking perspective, the Commission must determine whether the rates that
2 will result from this specific proposed approach will be just and reasonable.

3 A numerical example can play an important role in helping the Commission make
4 a well informed decision. Such an example provides the Company, who bears the burden
5 of proving to this Commission that its specific approach is reasonable, the opportunity to
6 illustrate the operation of the mechanism, as well as to quantify the implications for both
7 ratepayers and shareholders. It provides Commission Staff, and intervenors, the ability to
8 prepare comparative analyses of alternative approaches upon which to base their
9 recommendations.

10 Ms. Bateman, on pages three and four of her rebuttal, indicates that there is no
11 need for a numerical example because, under its proposal, the Company is only seeking
12 to recover its actual program costs, its actual net lost revenues, and PPI levels that the
13 parties to its settlement in North Carolina considered to be appropriate. From a
14 ratemaking perspective, we would urge that the Commission find those facts necessary,
15 but not sufficient. In other words, any approach approved by the Commission should, of
16 course, specify the program costs, net lost revenues and incentives that the Company
17 could recover in its rates. However, the key question for the Commission in this
18 proceeding is whether the *specific* approach that the Company is proposing is better than
19 other available approaches. An examination of the Company's proposal from that
20 perspective would provide support for a determination of whether the proposal would, or
21 would not, produce rates that are just and reasonable. But PEC has not provided this
22 information, and is incorrect when it says it *need not* provide this information.

For example, Ms. Bateman states on page 11 that “there is no empirical methodology to precisely determine the appropriate incentive levels.” What Ms. Bateman does not acknowledge is that one can, and should, prepare a numerical analysis of the Company’s proposed remuneration approach that compares it to alternative approaches. The results from that type of analysis would enable all parties to compare those alternatives according to explicit criteria such as rate impacts, level of earnings achieved by the Company and sharing of net benefits between ratepayers and shareholders—not to mention the relative cost to ratepayers of each kWh of energy efficiency savings.

WHY ARE YOU PLACING SUCH EMPHASIS ON THE NEED TO ASSESS THE COMPANY’S PROPOSED COST RECOVERY APPROACH AT THIS POINT IN TIME?

My goal in raising various questions regarding the Company’s proposed cost recovery approach is to contribute to the selection of an optimal rate-recovery approach—one that is fair to ratepayers *and* the Company, and one that will therefore enable PEC to sustain a major emphasis on energy efficiency over time. This is the time to raise those questions because the Company is just starting what hopefully will ultimately grow into a major initiative to meet a significant portion of its customers’ future requirements through improvements in energy efficiency. One of the factors that will determine whether the Company can achieve that objective, and sustain it over time, is whether ratepayers from all rate classes will view the resulting rates as just and reasonable. In other words, does

1

2

3 **Q.**

4

5

6 **A.**

7

8

9

10

11

12

13

14

15

16

17 **Q.**

18

19

20

1 A. Ms. Bateman maintains, on page 5 of her testimony, that the Company's proposal is
2 remarkably similar to the cost-recovery procedure advocated by the environmental
3 intervenors in the Duke Energy Save-A-Watt proceeding. I disagree.

4 The Company's proposal differs in two major respects from the cost-recovery
5 procedure filed by the environmental intervenors in the Duke Energy Save-A-Watt
6 ("SAW") proceeding. First, the cost-recovery procedure filed by the environmental
7 intervenors in that proceeding was premised on Duke Energy treating its program costs as
8 expenses and recovering them in the year in which they were incurred. Under that
9 approach Duke Energy shareholders would have the opportunity to earn "a bonus
10 incentive," comparable to the Company's proposed PPI. In contrast, under the
11 Company's proposal, program costs will be treated comparable to capital costs and
12 recovered over ten years. Under this approach the Company's shareholders have the
13 opportunity to earn *two* incentives—a return on equity on the unamortized balance of
14 program costs each year plus the PPI. Second, under the cost-recovery procedure filed by
15 my clients in the SAW proceeding, shareholders would not be eligible to receive that one
16 bonus incentive if Duke Energy did not meet pre-specified target levels.

17 **Q. PLEASE DISCUSS MS. BATEMAN'S POSITION THAT THE RETURN ON**
18 **EQUITY THE COMPANY WOULD EARN UNDER ITS PROPOSAL IS NOT AN**
19 **INCENTIVE.**

20 A. Under the Company's proposal, it would treat its program costs as being comparable to
21 capital costs, and amortize them over a ten year period. According to provision twenty in
22 Williams Exhibit No. 1, "PEC shall be allowed to earn a rate of return..." on the

1 unamortized balance at the overall weighted average net-of-tax rate of return approved in
2 its most recent general rate case.

3 Ms. Bateman states that the return that the Company will earn is not an incentive,
4 but instead is simply the cost of money or carrying cost that the Company will incur to
5 finance that unamortized balance. I disagree. A portion of that return is a return on
6 equity, which is an incentive. The Company's overall weighted average net-of-tax rate of
7 return reflects the relative quantities of capital it obtains from borrowing and from
8 shareholders, i.e. debt and equity respectively, as well as the rates it has to pay in order to
9 obtain capital from each source, i.e. rate for debt and return on equity. The opportunity to
10 a return on equity on capital investments is the financial incentive that drives the
11 Company, and other utilities, to make investments in traditional forms of generation.
12 Clearly, this has been sufficient incentive on its own to encourage utilities operating in
13 the Carolinas to plan and build new power plants. It is hard to deny that this is an
14 incentive, in and of itself.

15 Furthermore, in order for the Company to earn its overall weighted average net-
16 of-tax rate of return, it must earn a higher return "pre-tax." For example, in North
17 Carolina the Company's after tax return was 8.8063 percent. To earn that amount,
18 however, it had to earn a return of 14.4805 percent pre-tax.¹ As a carrying cost, 14.5
19 percent is substantially higher than the rate a credit-worthy borrower would pay for a ten-
20 year loan under current market conditions.

¹ North Carolina Docket E-2 Sub 931, PEC Exhibit No. 1, Workpapers, June 6, 2008, W/P C-1.

1 **Q. PLEASE DISCUSS MS. BATEMAN'S OPPOSITION TO TYING THE PPI TO**
2 **ACHIEVEMENT OF A PERFORMANCE TARGET,**

3 A. Under the Company's proposal, it would earn the PPI on whatever level of reductions it
4 happens to achieve. In My Direct Testimony I support tying the PPI to achievement of a
5 performance target. Ms. Bateman states that this proposal is unfounded and impractical. I
6 disagree.

7 It is practical to set a performance target; what is in contention is the appropriate
8 level of that target. For example, in North Carolina, the Company has provided
9 projections of the reductions that it expects to achieve from its initial set of efficiency
10 programs (though it has yet to disclose any program details to the Commission in this
11 docket). The Company could propose that those projections be the basis for its proposed
12 performance target. My impression is that the Company wishes to avoid the possibility
13 of performance targets being set at higher levels based upon the evidence presented by
14 Staff and other intervenors regarding higher levels of reductions that could be achieved.

15 As noted in my Direct Testimony, in several states, the award of bonus incentives
16 is conditional on achievement of performance targets—and unlike PEC, the utilities in
17 those states are not *also* earning a return on unamortized program costs.

18 Performance targets are also consistent with the manner in which the Company
19 earns a return on its investments in supply resources. On the supply-side, the Company
20 begins by identifying and justifying the size and type of new unit to construct. It does not
21 start earning a return on that resource until it completes construction and the investment
22 is placed in rate base. Moreover, the Company does not have the opportunity to build

1 only a portion of the unit and start earning a return on that portion, it either builds the
2 entire unit or it builds nothing. Similarly, the Commission should condition payment of
3 returns to the Company on its achievement of some appropriate, quantifiable energy
4 efficiency goal—not simply allow it to get paid for however much it does.

5 **Q. PLEASE DISCUSS MS. BATEMAN'S OPPOSITION TO APPLYING A CAP TO**
6 **THE PPI**

7 A. Under the Company's proposal, there would not be any cap on the absolute amount it
8 could earn as a PPI. My Direct Testimony supports capping the absolute amount of PPI
9 the Company could receive. Ms. Bateman opposes this proposal on the grounds that it
10 will limit the Company's incentive. While I understand her point, I consider it important
11 to have a cap under a shared net savings PPI in order to prevent unreasonable, windfall
12 earnings. For example, without a cap the Company's level of PPI could increase
13 substantially as a result of various external factors increasing its avoided costs, such as
14 sharp increases in coal prices, natural gas prices or the costs of complying with new
15 regulations on carbon emissions.

16 **Q. DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?**

17 A. Yes.

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-2, SUB 926
DOCKET NO. E-2, SUB 931

DOCKET NO. E-2, SUB 926

In the Matter of
Petition of Carolina Power & Light Company,
d/b/a Progress Energy Carolinas, Inc., for
Approval of Proposed Distribution System
Demand Response Program

and

DOCKET NO. E-2, SUB 931

In the Matter of
Application by Carolina Power & Light
Company, d/b/a Progress Energy Carolinas,
Inc., for Approval of DSM and Energy
Efficiency Cost Recovery Rider Pursuant to
G.S. 62-133.9 and Commission Rule R8-69

POST-HEARING ORDER

BY THE CHAIRMAN: Upon review of the record in the above-referenced dockets and as a result of the questions raised by the Commission at the evidentiary hearing held on January 7 and 8, 2009 in Raleigh, North Carolina, the Commission finds good cause to request that Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc. (PEC or Company) file the following information in these dockets as verified late-filed exhibits.¹ All late-filed exhibits shall be filed not later than Friday, February 13, 2009, and earlier if possible.² The parties to the Stipulation that was entered and filed on December 9, 2008, shall also file responses as required by this Order. All parties to this proceeding shall be granted an extension of time until Friday, February 27, 2008, within which to file their respective briefs and proposed orders.

¹ The requested information may, in some instances, duplicate requests made by the Commission during the course of the hearing. Any duplicate requests are included as part of this Order to ensure that the Commission has provided a complete list of all information to be provided by PEC as late-filed exhibits.

² The requested information should be filed on a daily basis as it becomes available, beginning as soon as possible, rather than waiting to file all such information at one time on the final due date.

Manass Supplemental Exhibit 1, Sched
schedule which details the Company's
related to the Retail Utility Cost Test re
Such amounts for the Retail Utility Cost

d detail how the year 1
explanatory footnotes;
nderlying assumptions

ers showing, at
eriod of analysis
net-of-tax basis.

- Overall
- Conservation
- Demand Response
- Overall
- (4) Future value of expected cash inflows:
 - Residential
 - Nonresidential
 - Overall
 - Conservation
 - Demand Response
 - Overall
- (c) A schedule, in comparative form, setting forth the following information and data:
 - (1) Projected MWh savings:
 - Residential
 - Nonresidential
 - Overall
 - (2) Projected MWh savings as a percent of 2008 MWh sales:
 - Residential
 - Nonresidential
 - Overall
 - (3) Projected MW savings:
 - Residential
 - Nonresidential
 - Overall
 - (4) Projected MW savings as a percent of 2008 summer peak demand:
 - Residential
 - Nonresidential
 - Overall
 - (5) Projected per-month cost to customers (\$):
 - Residential
 - Nonresidential (assuming no opt-outs)
 - (6) Projected per-month increase in cost to customers (%): ³
 - Residential
 - Nonresidential (assuming no opt-outs)
- 9. With regard to PPIs and the net lost revenues that are proposed to be recovered through the DSM/EE rider, please provide a detailed narrative explanation of how PEC plans to report such earnings in its quarterly NCUC ES-1 Reports. In such narrative, please provide the applicable NCUC ES-1 schedule number and line number references. In addition, please explain why the Company's proposed reporting of its PPIs and net lost revenues is appropriate.

³ This percentage increase in cost to customers is to be determined in comparison to rates currently in effect.

emergency, please provide the date, the duration, and a description of the specific conditions that caused the situation to be an emergency.

16. Is the Company's Save-the-Watts ad campaign covered by the Stipulation and, if so, what amount does the Company propose to recover through the DSM/EE rider for such purpose during the first 12-month billing period and for each of the remaining nine years of the 10-year period?

An Issue to Be Briefed By The Stipulating Parties

1. The Stipulation, on Page 6, at Paragraph 32, provides that the Commission is required to make certain findings regarding approved incentives. In your respective briefs and proposed orders, please provide specific references to such evidence and findings contained in the record of present proceeding related to the agreed-upon incentives.

IT IS, THEREFORE, SO ORDERED.

ISSUED BY ORDER OF THE COMMISSION.

This the 30th day of January, 2009.

NORTH CAROLINA UTILITIES COMMISSION

Gail L. Mount

Gail L. Mount, Deputy Clerk

fh013009.01

CL De Sol